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C O N F I D E N T I A L SECTION 01 OF 03 LAGOS 000924

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E.O. 12958: DECL: 06/09/2015
TAGS: ECPS ECON NI
SUBJECT: NIGERIA: TELECOMMUNICATIONS SECTOR ROUNDUP

Classified By: Consul General Brian L. Browne for reasons 1.4 (b) and (d).

¶1. (U) Summary. Since digital mobile licenses were awarded in 2001, Nigeria has improved from 400,000 telephone lines -- the world's third lowest telephony per capita rate -- to 10 million lines. This expansion has moved the country from a telecom emerging market to a quickly maturing market. There is strong competition, increasingly from the Chinese who offer the advantage of deeply discounted loans. Having graduated the euphoria of simply having a phone, the Nigerian new consumer demands low prices and quality service. The stiff competition along with other economic factors may affect future prospects for some service providers. The Nigerian Communications Commission (NCC) recently announced fixed wireless (FW) operators can offer nationwide services starting in February 2006 under a unified license, putting FW operators in direct competition with the more popular Global Service for Mobile communications (GSM) providers. Telecom sector deregulation and growth has been in Nigeria, a country where most other reforms have been slow to take root. End summary.

TELECOM DEREGULATION A BIG SUCCESS

¶2. (U) Nigerian telecommunications deregulation has been a success. In 2000, Nigeria's over 130 million people were reliant on a paltry 400,000 telephone lines with parastatal telephone company, NITEL, as the only telecom provider. In January 2001, the Nigerian Communications Commission (NCC) offered four national Global Service for Mobile communications (GSM) licenses, and additional regional fixed wireless (FW) licenses, sparking an unprecedented rollout to meet pent up demand. Four years later, the telephony rate has jumped from .4 lines per 100 individuals to an estimated 5.6 lines per 100. Most of this increase is due to GSM lines, which total eight million and are still increasing. A recent international information and communications technology research study estimated the Nigerian mobile market has achieved less than one third of its potential and predicted subscribers to number 23 million by 2007.

CHINESE EQUIPMENT ENTRANTS AND THE CHEAP FINANCING THAT INGRATIATES THEM IN NIGERIA

¶3. (C) Chinese equipment companies want a piece of the Nigerian telecom pie, and their government is willing to guarantee rock-bottom financing terms to help them gain market share. One American company, Harris Communications Systems Nigeria (Harris), is being seriously affected. Part of the Harris Corporation Microwave Division, the largest supplier of microwave systems in North America and a worldwide supplier, Harris has been the most dominant microwave telecom equipment player in Nigeria, competing with companies like French-owned Alcatel, German-owned Siemens, and Japanese-owned NEC. Harris Nigeria Country Manager, Peter Yap, said Harris confronts increasing numbers of contracts bid by Chinese companies advantaged by Chinese government backing on "crazy financing terms." At a time when changes in the banking sector, political uncertainty in Nigeria make project financing difficult, the Chinese Government is eagerly guaranteeing loans at three percent over six years (a one-year moratorium with five years to repay). The best Harris can offer is five percent with a two- or three-year repayment. Even this is a no-profit stretch made just to keep the business, according to Yap.

¶4. (C) In May 2005, the Nigerian Ministry of Communications signed a USD 200 million deal with China's Huawei Technologies Company (Huawei), and a USD 95 million contract with Chinese-owned ZTE, to provide telecom networks in Nigeria's rural areas. Both were underwritten by Chinese Development Bank (CDB) loans. Industry experts are skeptical these projects will be implemented. They note the difficulties in verifying and monitoring projects in remote, rural areas. Additionally, the project cannot produce sufficient returns to repay the CDB loan. The CDB, analysts

argue, is apparently willing to overlook Nigeria's poor track record on rural development projects, in hopes of promoting the Chinese presence in this country. Telecom interlocutors such as Yap and J.P. Snijders, Chief Regulatory Officer of Vmobile, are convinced China's telecom interests now, is a conscious risk--perhaps a "loss leader" for more lucrative oil contracts later.

¶5. (C) Harris believes more serious problems with Chinese companies are down the pike. Yap is worried Chinese telecom equipment suppliers will illegally transfer technology, pirating the Harris microwave technology to build and sell for themselves. For example, Huawei approached Yap with a deal to offer Harris microwave equipment under a Huawei umbrella contract with the GSM operator, VMobile. Huawei will supply all equipment needs for one of Vmobile's network expansion areas. For equipment that it does not itself manufacture, such as microwave components, Huawei will look to external sources like Harris. Huawei has set the deal up to be attractive to all players: Vmobile benefits from good financing terms and the reliability of Harris product, and Harris still gets a sale. However, Yap strongly believes this could be a vehicle for technology transfer of microwave equipment where Harris currently holds its comparative advantage for the Nigerian market.

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COMPETITION, BANKING AND FULL REFORMS CHANGE MARKET
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¶6. (C) The initial oohs and ahhs of average Nigerians making their first telephone calls gave way to increased competition and a GSM price war broke out in September 2004. Connection charges went from naira 20,000 (about USD 150) to as low as one naira today, helping to boost subscriber numbers to the eight million mark. Reduced connection charges enabled thousands of Nigerians to own mobile phones, yet these same Nigerians do not have the sufficient steady disposable income to regularly make phone calls at naira 30 (USD .23) per minute for GSM and naira 6.5 (USD .05) per minute for FW. In the second half of 2004, new banking reform plans and the GON reduction in fuel subsidies were depressive factors on disposable income. Nigerian consumers were left with less money to spend on pre-paid recharge cards for their GSM and FW phones, leading to what some industry watchers called a "hollowing out" effect: telecom companies earn revenue up front on a high subscriber base, but then see low returns when subscribers do not use the phones. Dirk Smet, Managing Director of the Nigerian FW operator, Starcomms, said from September 2004 to April 2005 his company's revenue per subscriber (RPS) declined by 30 percent while South African-owned GSM operator, MTN Nigeria, lost 25 percent.

¶7. (C) Operators are focused on network expansion beyond the major urban centers, and enhanced services such as very small aperture terminal (VSAT) services, to stay ahead of the competition. Snijders of Vmobile says the cost of expanding is straining most operators, with current debts from rollout and startup costs estimated to be about USD eight billion for total industry debt. With the price war, operators' funding needs have only increased. He confirmed that Vmobile's strategy includes takeover talks with UK's Virgin Mobile and, like MTN, Vmobile is considering raising funds from the domestic stock market. Smet believes the FW market will consolidate through mergers or acquisitions for operators to survive the current trend of fierce competition.

GSM SOON TO COMPETE WITH FW

¶8. (U) In February 2006, the Nigerian Communications Commission (NCC) will award "unified" telecom licenses, differing from licenses today specified for GSM or FW service. The NCC stated no new operators will be licensed, but that existing mobile and FW operators will be allowed to provide both services for voice, data and multimedia. The greatest effect expected is that FW operators will come closer to direct competition with their GSM counterparts, offering roaming services nationwide compared to their licenses today confined to specific geographic areas. Multi-Links, for example, is a FW provider with service in Lagos and its surrounding areas, but subscribers cannot make calls while in Abuja or other cities. If Multi-Links acquires a unified license, it will operate in direct competition with GSM companies whose call charges are about six times higher, on average, than FW operators'.

¶9. (U) GSM operators seem to be fighting the general perception that their success has led to windfall profits, despite the debt burden of nationwide network backbone rollouts. The Nigerian Investment Promotion Council (NIPC) recently withdrew the "pioneer status" of MTN and Vmobile

unexpectedly, denying them further tax breaks. This, along with the unified licenses, GSM operators say, discourages investment in a sector already experiencing a funding crunch.

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"TAXATION": HOW CAN I GET SOME FROM THE TELECOM WINDFALL?
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¶10. (C) Snijders says Vmobile and other telecom companies are increasingly asked to pay unfounded taxes and fees as more Nigerians perceive that money is being made in the telecom sector. According to Snijders, GON agencies which have only marginal dealings with telecom players, are looking for such payments. For example, the Nigerian Civil Aviation Authority (NCAA) recently mandated a naira 500,000 (about USD 3800) "tax" for construction approval of every base station, with a naira 200,000 (USD 1500) annual renewal fee. Besides these new fees, Nigeria sustains a 35 percent import duty levied on telecom equipment. Additionally, the Central Bank of Nigeria recently directed the NCC to approve all telecom operator payments for intangible products such as software licenses providing additional windows for illegal rent-seeking. Delays and bureaucracy in the approval process usually result in temporary withdrawal of such licenses resulting in network problems. These costs, in addition to huge costs incurred in providing basic infrastructure, like power, make operating in Nigeria more expensive than most other places. Yet the perception that operators, particularly GSM operators, are making money here persists.

NO TURNING BACK

¶11. (C) Comment. Despite the high cost of doing business in Nigeria, and the country's market riskiness, GSM operators are showing no signs of scaling back, and FW operators look forward to benefitting from the February 2006 unified licensing. 2004 and 2005 have seen unprecedented growth in the sector. One industry research group expects phone lines to grow from the current eight million mark to 32 million by ¶2009. Besides the fact that Nigerians who have never before used a phone are making calls, the industry has had a gross positive impact on the economy, accounting for an estimated USD four billion in foreign investments since 2001 if Internet service, handset sales and service, and recharge card production and sales are included in the calculation. Changing the way Nigerians do business, the informal sector has become better integrated into the economy, and artisans and sellers are more easily reached to provide services or goods. However, urban areas have disproportionately benefited from the telecom revolution.

12) (C) Nigeria's telecom sector liberalization and reforms are nonetheless fragile, like most reforms in Nigeria. The NCC, its chair, Ernest Ndukwe, and its current regulations and licensing procedures are conducive to business development and investment. However, looking forward, the GON will have to craft its economic policies carefully to ward against unintended effects such as the banking recapitalization reform temporarily drying up business financing as banks restrict lending in order to shore up their capital reserves. The GON will also need ensure transparency and the rule of law so that all companies get a fair chance at establishing themselves in what looks like a growing market. However, the Chinese have apparently made a strategic decision to sacrifice economic profit in the near terms to obtain greater market share. To the extent the Chinese succeeds, American companies will find it tough to compete. End comment.
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